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EA M 86 20092OCR 3P&PD 1**DIRECTORATE OF INTELLIGENCE**

15 July 1986

**Chinese Battle Over Bankruptcy**

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**Summary**

The June debate in the Standing Committee of the National People's Congress (NPC) -- China's equivalent of a parliament -- over a draft of China's first bankruptcy law and the NPC's failure to vote on the law do not necessarily constitute a major defeat for reformers. We believe instead that the debate indicates the changing role of the NPC, and that the reformers probably did not expect a final draft to be passed at this session. We still expect passage of a revised draft soon, possibly this year.

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This memorandum was prepared by \_\_\_\_\_ Office of East Asian Analysis. Information available as of 15 July 1986 was used in its preparation. Comments and queries are welcome and may be directed to the Chief, Domestic Policy, China, OEA/CH, \_\_\_\_\_

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### Key Component of Reform

Reformers, including Premier Zhao Ziyang, Vice Premier Tian Jiyun, and Secretariat Member Hu Qili -- have been pushing for adoption of a bankruptcy law to encourage efficiency in ineptly run enterprises. Although Chinese [ ] widely agree that the law would be used infrequently, as a last resort in dealing with chronic money losers, it represents an important step in making enterprises responsible for their losses.

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Since the beginning of the year, at least five members of the Politburo and numerous high-level officials have called for a bankruptcy law, albeit without setting any timetable for passage. On 15 May, State Council Legislation Bureau Deputy Director Wang Shirong announced that a bankruptcy law was one of a series of economic reform laws that "will be examined and promulgated this year." Consequently, when a draft of the law was presented to the June NPC Standing Committee session for debate, it was generally anticipated in the West that the normally docile NPC would approve the draft without a major fight. [ ]

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Surprisingly, the NPC neither voted on nor made a recommendation about the law, after a debate that was described as "intense" by US Embassy sources. Chinese press reports made little effort to disguise the disagreement. A 24 June Xinhua report in English quoted one delegate as arguing that the law should be passed "as early as possible," while citing other delegates who said "the time is not ripe to issue it." [ ]

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### Political Complexities of Bankruptcy

In our opinion, the positions on the bankruptcy law are complex and do not always fit neatly into "reformist" and "conservative" categories. Some NPC delegates argued that passing a bankruptcy law before the completion of price reforms would be irrational because China's cumbersome system of state-set prices often means that profits are determined more by the prices enterprises pay for raw materials and fuel than by managerial efficiency. A highly unusual Chinese Government opinion poll of almost 1,000 economic officials -- published in a major economic daily during the NPC Standing Committee debate -- also revealed strong concern over how the government would support and find new jobs for workers whose factories had gone bankrupt. US Consulate Officials in Shenyang have reported that advocates there have disagreed over which organizations -- the central government, the city, the industrial ministry, or the trade union -- should support workers who lose their jobs as a result of bankruptcy.

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A Chinese bankruptcy law also has raised nettlesome ideological issues, such as how the government of a socialist country can recover losses by selling off the assets of enterprises that are--in theory--owned by "the whole Chinese working class." [ ]

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### **A Reformist Defeat?**

Conventional wisdom -- based on the assumption that the NPC usually rubber-stamps State Council initiatives -- would suggest that the failure to vote on the draft law is a major defeat for advocates of enterprise reforms. The membership of the NPC Standing Committee -- which contains many retired party leaders considered to be lukewarm on reform -- lends some support to this view.

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The circumstances surrounding the NPC debate strongly indicate to us, however, that the reform leadership probably did not expect a final draft to be passed at the current NPC session, and is still seeking reactions to the draft. The NPC Standing Committee session was one of several meetings in which opinions were being sought, and is part of the process of building a consensus on this complex issue.

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On 20 June, a Xinhua report disclosed that a major national meeting of over 200 experts on bankruptcy law, convened by the bankruptcy law drafting team, was still in progress in Shenyang as of 19 June -- three days after State Economic Commission Vice Minister Zhang Yanning read out the draft of the law at the NPC session. We believe it is highly unlikely that the reform leadership would have submitted a "final" draft to the NPC for passage while the drafting committee and several hundred of the nation's leading authorities on bankruptcy were still discussing the issue in Shenyang. Also, the publication during the Congress of the above-mentioned poll results -- which showed mixed reactions to the draft -- indicates that the reform leaders recognized the lack of consensus on the draft. Finally, preconference reporting that the NPC was only to "hear" and "discuss" the draft suggests that the leadership did not believe that they had a consensus document, and did not expect the law to pass at that time.

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### **Bankruptcy Law Still Expected**

The intense and open debate in the NPC indicates both that the bankruptcy law is controversial, and that the NPC is becoming a somewhat more active deliberative body, rather than remaining the rubber-stamp organization that it once was. In June 1985, the NPC played a similar role as a forum for airing diverse views on a complex legal issue when it debated -- and at first did not pass -- a State Council draft of the mining law that has since been adopted.

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Despite the reservations expressed about the draft, we believe that the reformists still control the initiative in the current debate, and have left their critics in an awkward position. Bankruptcy law critics have been reduced to debating legal details and the timing of the law's passage, and have been forced to justify their stance on the grounds that other systemic reforms -- and particularly price reforms -- have not gone far enough to create the necessary conditions for bankruptcy legislation. The reformists must still work out a politically acceptable compromise draft and finish preparing the other companion legislation that the NPC deputies have called for, but with so many top-level officials advocating a bankruptcy law, we still expect passage of a draft soon, possibly this year.

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**Subject: Chinese Battle Over Bankruptcy** [redacted]

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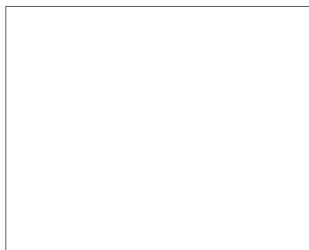
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